Internal control over fixed assets accounting essay

Maintaining control over plant and equipment: subsidiary ledgers Unless internal controls over plant and equipment are carefully designed many units of equipment are likely to be broken, discarded or stolen without any entry being made in the accounting records for their disposal. The assets accounts will then be overstated and depreciation programs for such missing unites of equipment will presumably continue. Consequently net income will be misstated because of the omission of losses on retirement of plant assets and because of erroneous depreciation charges.

One important control devise which guards against failure to record the retirement of assets is the use of controlling accounts and subsidiary ledgers for plant and equipment. The general ledger ordinarily contains a serpent assets account and related depreciation accounts for each major classification of plant assets, such as land, buildings , office equipment and deal very equipment. For example the general ledger will contain the account office equipment and also the related accounts depreciation expense: office equipment and accumulated deportation: office equipment, the general ledger account, office equipment, contains entries for a variety of items: typewriters, filing cabinets , dicta phones, desks, etc It is not possible in this one general account to maintain adequate information concerning the cost of each item, its estimated useful life, book value, insured value, and other date which may be needed by management as a basis for decisions on such issues a replacement, insurance and taxation.

A subsidiary ledger should therefore be established for office equipment, and for each of the other general ledger accounts which represents many separate units of plant property. The subsidiary ledger in a manual accounting system may consist of a card life, with a separate card of each unit of property, such as a typewriter or desk. Each card shows the name of the asset, identification number, and such as details as date of acquisition, cost, useful life, depreciation, accumulated depreciation, insurance coverage, repair, and gain or loss on disposal. The general ledger account, Office Equipment, serves as a control; the balance of this controlling account is equal to the total cost of the items in the subsidiary ledger for office equipment, The general ledger account, Accumulated Depreciation: Office Equipment, is also a controlling account; its balance is equal to the total of the accumulated depreciation shown on all the cards in the office equipment ledger. Every acquisition of office equipment is entered in the controlling account and also on a card in the subsidiary ledger . Similarly , every disposal of an item of office equipment is entered in both be controlling account and the subsidiary ledger.

Each card in a subsidiary ledger for plant and equipment shows an identification number which should also appear in the form of metal tag attached to the asset itself. Consequently, a physical inventory of plant and equipment can be taken and will prove whether all units of equipment shown by the records are actually on hand and being used in operations.

Other advantages afforded by a plant and equipment ledger are the ready availability of information for the periodic computation of depreciation, and for entries to record the disposal of individual items of property. A better basis is also available for supporting the date in tax return, for obtaining proper insurance coverage , and for supporting claims for losses sustained on insured property. In well managed companies , it is standard practice to control expenditures for plant and equipment by preparing a budget of all planned acquisitions for at least a year in advance. A first essential to the preparation of such a budget is a detailed record showing the assets presently owned, their cost, age , and remaining useful life.

Plant and equipment:

Transactions that change the amount of investment in the plant and equipment of a business have a tendency to occur infrequently and to involve relatively large amount Current assets, on the other hand , are in more or less fluid state, undergoing smaller changes constantly. Although a company's methods of internal accounting control generally apply to all transactions, whether they relate to current assets or to plant and equipment . the auditing procedures differ for the two groups. In auditing current assets at the balance sheet date, the auditor is concerned with the balance on hand. changes that occurred during the year are not substantiated in detail except in audits designed as complete audits, With plant and equipment , the auditor is concerned with all changes that took place during the audit period regardless of the type of audit that is being performed ALL of any substantial amount that either increase or decrease the value of such assets must be examined.

LAND:

Land used in the operation of a business should be recorded separately from land acquired as an investment or speculation. Procedures in accounting for the two types of land differ considerably. Land held for business use appears on the balance sheet as

a part of plant and equipment, and expenses associated with it are operating expense, whereas land acquired as an investment is classified with other investment assets, and applicable expense sometimes are capitalized, they are treated as non operating or financial expenses.

Land acquired for use in the operation of a business should always be recorded separately from the building that may be located thereon. The principal reason for this is that the buildings are subject to depreciation, which must be treated as an operating cost, while it is not customary to take into consideration any depreciation on land in ascertaining the operating costs of a business. In cases where an auditor finds land and building recorded in a single real estate account , he should recommend a segregation of the land and buildings with a specific value on each. This will facilitate the computation of depreciation of building apart from the land.

Land is, in a sense, the most permanent asset of a business, the auditor should ascertain that the land account is charged with(1) the original cost,(2) the expenses incident to the purchase, such as a cost of investigating the title, recording the deed, commissions paid, and any other expenses that represent an addition to the purchase price and(3) the cost of subsequent improvements that increase the value of the land, such as draining, grading, building approaches, assessments for sewers, and treat improvements. Not infrequently. Assessments for improvements charged off as current operating expenses. Such costs, however, should be charged to the land account.

When land is sold. The land account should be credited with the cost price, while the difference between the cost and the selling price should be recorded separately as a

loss or a gain. Under this procedure the balance of the land account will always represent the original cost plus the cost of improvements of the land owned.

Vehicles:

Every organization that has vehicles must have a vehicle politics. This will write down the policy on a range of cases such as:

Insurance

Depreciation

Repair and Maintenance

Purchasing, disposal and replacement

Private usage of it by staff

What needs to be done when an accident happen

Driver training and qualifications

Carrying the passengers

The costs of replacement and repair must be good in the budget procedure. For every vehicle there must be a record of journeys so that the operation costs per Km can be evaluated and private use closely monitored.

Buying fuel for cash is risky, and it might be safer to establish an account with a reputable fuel company and pay every month by check instead

Buildings:

Buildings may be acquired through the purchase of real estate in which case separate values should be placed upon the buildings and land, the basis of the valuation being cost. In the preparation of annual should be valued at cost plus addition and

Improvements less the depreciation. For balance sheet purposes, the buildings are generally listed at cost with the allowance for depreciation being deducted. The difference is extended as the book value of the buildings.

Occasionally they question arises whether the accounts for buildings, as will as land and other types of plant and equipment should be marked up from the basis of cost to a higher current value determined by an appraisal. In the audit of the buildings account the auditor should prepare working papers in which different buildings are segregated. These working papers should show the book values at the beginning of the period under audit the cost of additions or deductions during the period. These beginning and ending balance should be checked with the amount of the building and ending balance on the balance sheet as both dates and should be in agreement with the account on the books. If the subsidiary building ledger is maintained it should be compared with the controlling account in the general ledger to see that they agree . all additions and deductions during the period should be carefully examined to be sure that they have been properly accounted for, due care being used to distinguish between capital and revenue expenditure.

AUDIT OBJECTIVES

Audit procedures to be followed when examining plant and equipment records are designed to acquaint the auditor with the recording methods used. To assure him that the claim of ownership is valid, and to assist him in determining that the assets do in fact exist and that the provisions for depreciation are adequate but not excessive. they also help in determining that internal accounting control is adequate that property accounts show consistent treatment of properly capitalizable items, hat no significant additions to properties have been charged to income, and that proper retirements and replacements.

Elements of Internal Control over fixed assets

Fixed Assets are sometimes referred to as Property, Plant and Equipment (PP&E) and the terms are used interchangeably. In many companies the following elements of Internal Control over PP&E are considered and performed according to standard guidelines:

Approval process for Capital Expenditures (Capex)

Determination whether planned expenditure is capitalized or expensed

Purchasing and Accounts Payable systems are correctly applied

If capitalized, appropriate useful life and salvage value determined

Correct depreciation expense is calculated and applied each period

Property tax reports filed with tax jurisdictions

Insurance coverage relates directly to asset exposure

However, there is one critical element of Internal Control that often is missed. This involves periodically checking that the information shown in the property record system corresponds to the actual assets reported to be there. To put this into

perspective, a company may have a very good system of invoicing and accounts receivable, but it is still necessary to confirm that outstanding balances as part of the required annual audit. One well known aspect of this is the verification of ageing debts in the A/R ledger to confirm their collect ability.

Similarly, with inventory (raw material, work in process and finished goods), for the past 70 years companies have been required to perform a physical count and valuation at least once a year. Further, auditors are required to monitor closely the inventory taking and pricing. In the case of perpetual inventory systems, periodic sample testing is required, again with external auditor input. After the reconciliation of receivables and inventory, adjusting entries must be made to bring the accounting records into agreement with the underlying assets. It is equally necessary that the same kind of reconciliation of reported balances to actual physical assets is in place because for many companies, PP&E may represent 35% or more of total assets. Without a periodic reconciliation, the property record system will lose accuracy as items are scrapped or enhanced. If a reconciliation is performed and adjusting entries made, however, the resultant asset category totals have been verified. Management can then sign with confidence the Section 404 certification – its assertion that there is a system of Internal Controls and that the system is working properly.

The Assets Register

An Assets registry should be established with a record sheet or an entry for each asset. Each asset must be given a unique ref number for identification goals. The register will include information about when and where the item was purchased; how much it's insured for; how much it cost; repair history; ref number, serial numbers and details of guarantees and warranties. It may also contain information on depreciation, if it is pertinent.

The entry should state where the item held and who is responsible for its security and maintenance. The Assets Register must be checked by a committee member and senior manager each quarter or any discrepancies reported and take the appropriate action.

Internal Control of Fixed Assets: A Controller and Auditor's Guide:

What are standard fixed asset control procedures? Tagging & labeling of assets – assets are labeled or tagged so that they can be easily identified & their ownership established I insurance of assets against theft, fire, flood etc.- in most countries, only vehicles are insured. But it is a recommended practice to insure all project assets. In some financing agreements, this is mandatory Physical inventory of assets at regular intervals Log books for vehicles , construction equipment, generators etc. The log book records the details of use of the asset & is usually maintained by the driver or operator. It helps in identifying personal use of project assets. It is also used for calculating fuel consumption Cross referencing of financial & fixed asset records – done to avoid payment to supplier before assets are recorded in the FAR. For internal control purposes it is vital to reconcile the financial accounting records with fixed asset records Note: In some countries, it is the Government Policy to only insure vehicles.

Auditing… second edition…….. silvoso. bauer****

****Accounting the basis for business decisions……. fifth edition……… walter B. meigs and Robert F. meigs.